



California Business, Transportation & Housing Agency

Public Infrastructure Advisory Commission Proposed Work Plan for 2011

Introduction

In 2009, California joined the growing number of states expanding models for leveraging private sector capital, innovation and efficiencies to accelerate transportation projects that might otherwise be deferred indefinitely. In addition to authorizing public-private partnerships (P3s), SBX2 4 (codified as Streets & Highways Code section 143 et. seq.) required the State's Business, Transportation and Housing Agency (BTH) to establish the "Public Infrastructure Advisory Commission" (PIAC) to, among other things, identify transportation project opportunities for P3s and advise the Department of Transportation (Caltrans) and regional transportation agencies regarding infrastructure partnership suitability and best practices.

Since the enactment of SBX2 4, the State has moved quickly to establish procedural and review guidelines, identify candidate projects, convene the PIAC, conduct outreach to government and industry stakeholders, and take other steps to implement the new authority. There is now an emerging "pipeline" of potential P3 opportunities that may require more than \$20 billion of capital. Some of the needed funding will likely be generated by local sales tax measures and bonds issued by regional transportation agencies for investments in transit and projects on the State Highway System. The State's capacity to invest will be extremely limited considering that current transportation funding – namely, the gas tax – supports barely 20 percent of existing needs, and there are no signs that the state or federal gas taxes will be increased in the foreseeable future. California's Legislative Analyst's Office (LAO) projects annual general fund shortfalls of \$20 billion through Fiscal Year 2015-16. The structural deficits call into question the State's ability to sustain infrastructure funding programs and manage debt service on general obligation bonds, which currently play a prominent role in the State's infrastructure investment strategy. Local and regional agencies face similar constraints.

According to recent reports, private investors will be looking to raise an estimated \$80 billion in 2011 to be invested in various forms of infrastructure around the world. This is in addition to more than \$100 billion previously raised and allocated to infrastructure investment. It's all but certain that governments around the world will seek to access this capital through various forms of P3 for all forms of infrastructure. It is well known that California has vast and growing needs for transportation, energy generation and distribution, water and waste water treatment, schools, courthouses and many other types of facilities that are vital to our economic and social vitality. As the world's eighth largest economy, California has the potential to become one of the most dynamic markets for infrastructure investment. But it remains to be seen how much private capital will be invested here.

While public agencies at all levels of government are considering ways to co-invest with the private sector, there continues to be pockets of public and political resistance to P3s owing to concerns regarding private sector profit motives, the potential loss of control over public infrastructure assets, and the perceived threats to public sector jobs, among others. In addition, many public agencies do not seriously consider the use of private capital based solely on historical reliance on government grants and public bond finance, and differences in the cost of public and private capital. Many agencies continue to rely on public bonding capacity to build infrastructure without any consideration of the full life cycle costs of an asset – the cost of capital being simply one element -- and whether such costs can be reduced or better managed with private sector capital, innovation or efficiencies.

Many of the frequently stated concerns about P3s are rooted in forms of partnerships that were prevalent but have now evolved in recent years. Five years ago, for example, P3s frequently were transactions involving the long-term lease of brown-field public assets (i.e., existing operating assets) in return for a large upfront payment to the leasing government. While this model remains prevalent in some jurisdictions in the United States, the current focus in California is primarily – though not exclusively -- on greenfield projects.

Capital structures and resulting cost of capital are also changing. Generally speaking, the mix of debt and equity is generally more balanced, and financing now comes from a combination of private and public sources. Combining public and private debt financing can produce capital structures with a significantly reduced weighted average cost of capital, which underscores the importance of undertaking project level business case analyses.

Logical Next Steps

While much has been accomplished or set in motion, more needs to be done to realize the full potential of P3s in California. The PIAC's prior deliberations have confirmed that California residents need to be better informed about the costs and benefits of infrastructure and the trade-offs associated with P3s. At its December 16, 2010 meeting, the PIAC considered the degree to which California's public agencies are prepared to continue investing in infrastructure. There was strong consensus that all stakeholders need to continue working to ensure that project sponsors have in place the necessary financial tools, well-prepared public employees, and the necessary support of environmental and labor advocates and the public.

This Proposed Work Plan for 2011 is based on extensive outreach and numerous public meetings and reports published within the past year. It sets forth a collection of steps that can set the stage to seize emerging opportunities. Recognizing that some of the actions and proposals will require further analysis and discussion, the Proposed Work Plan is intended to focus efforts and inform stakeholders as we proceed in developing a more robust market for P3s in California.

10 Steps to Develop the Emerging Project Pipeline

Currently, there is an emerging pipeline of seven projects that may proceed as public-private partnerships with an estimated *capital* costs in excess of \$20 billion. This does not include other projects that have yet to be identified or any of those currently planned for conventional delivery, but which may ultimately be considered for some form of P3 delivery. Notably, the Los Angeles Metropolitan Transportation Authority is moving forward with business case analyses for certain Measure R transit and highway projects, and the Bay Area's Metropolitan Transportation Commission is moving forward with the Bay Area Regional Express Lane Network. All of these are large transportation projects that will require private capital beyond what is available through existing public resources.

The State may be one of multiple parties contributing to the financing and delivery of these and other projects that emerge from the local or regional level, and Caltrans, with appropriate input from the PIAC, should continue working with local and regional agencies to enhance the overall readiness to proceed with financing and implementation strategies.

The Proposed Work Plan for 2011 consists of the following 10 priority steps that can significantly enhance the State's overall readiness to develop the emerging project pipeline:

1. Increase Public Sector Training on Infrastructure Finance and P3 Delivery Methods

Multi-party financing that includes public and private capital is increasingly common, but inherently complex, requiring a high level of contractual, legal, financial and operational competency. The Infrastructure Finance Academy (Academy) is a workforce development effort to upgrade the skills and expertise of public employees and agencies. The Academy is intended to be a partnership of public agencies that have a role in planning, building and maintaining all forms of public infrastructure. Building on the expertise of public employees that have current or past experience in negotiating public-private partnership agreements, the Academy will develop curriculum and provide training that combines a core curriculum of infrastructure project funding, finance, procurement, oversight, delivery and management with the technical skills and business knowledge needed to develop innovative financing solutions. This will include a focus on key concepts, including life cycle delivery, net present value, discount rates, and value for money. Participants will also receive training on how public and private financing structures compare with regard to: project selection, procurement, contract structure, risk allocation, tolling policies, revenue-sharing, performance standards, labor protections, contract management and oversight, public oversight and monitoring, default provisions, and termination provisions. To minimize costs and follow the trend toward online training, an initial prototype lesson has been prepared and made available online. BTH and Caltrans are working with other public agencies to gauge interest, gather input on content and format, and market the availability of the training. The Commission heard a presentation and discussion of next steps.

In 2011, training organizers should explore opportunities to collaborate with the California High Speed Rail Authority, Regional Transportation Agencies, Special Districts and USDOT's Office of Innovative Program Delivery and other agencies. While the Infrastructure Finance Academy and similar efforts can help educate public employees, elected officials and others, policy makers at all levels need to become better informed of how P3s work and the associated risks and benefits. This presents an opportunity for the PIAC to extend its role in upgrading public sector skills at all levels of P3 consideration.

2. Continue Developing Long-Term Policy on Life Cycle Cost Analysis

In addition to increasing awareness of life cycle delivery as a concept, public agencies need to be better prepared to implement life cycle cost analysis (LCCA) and delivery. Although Caltrans has been considering life-cycle costs when making design decisions, the analysis has been primarily limited to certain pavement and bridge projects. BTH and Caltrans are now preparing for a wider application of life-cycle cost analysis (LCCA) that would include the total cost comparison of competing alternatives by analyzing initial costs and discounted future costs, such as maintenance, user costs, reconstruction, rehabilitation, restoring, and resurfacing costs, over the life of projects, with consideration of other transportation projects within a corridor. Early efforts are focused on identifying the required vital

information necessary to implement LCCA for project-level planning. This includes a gap analysis to identify areas where additional research, policies or software tools may be required for department-wide implementation. Upon completion, Caltrans will be able to use LCCA to enhance the evaluation of project delivery methods and other investment decisions. The general timeline for the further development of this policy is as follows:

- January 2011: Complete LCCA framework and gap analysis
- February 2011: Obtain approval of framework and gap analysis
- March 2011: Initiate action to address the items identified on gap analysis
- TBD: Ability to analyze, compare, and select among financing options (value for money)
- TBD: Ability to analyze, compare, and select one corridor vs. another

As the policy is developed, relevant training can be included in the Infrastructure Finance Academy curriculum. Increasing awareness and the ability to apply LCCA should encourage decision-making relative to projects currently identified in the emerging pipeline and others that are expected to emerge in the near future.

3. Continue Developing Long-term Policy on Availability Payments

It seems likely that Caltrans will be one of multiple parties contributing to the financing of projects in the emerging pipeline, and its ability to support P3 project commitments should not be project-specific or renegotiated in each transaction. The absence of a systemic framework for ensuring the State's ability to fulfill financial commitments can add significant time and costs for the public and private sectors. Caltrans has implemented an internal policy to establish a level of future funding that should be prudently used to support P3 projects without unduly jeopardizing future transportation needs. This cap is set at 15 percent of the annual revenue levels and applies to both future state Grant Anticipation Revenue Vehicles (GARVEE bond) commitments and availability payments for P3 projects. It limits the amount of availability payments approved and required for P3 projects pursuant to California Streets and Highways Code Section 143. This policy mandates that the projected annual payments, together with the outstanding annual debt service payments on the GARVEE bonds may not exceed an amount equal to 15 percent of the total available federal transportation funds (after deduction for safety and other mandates) deposited into the State Highway Account for any 12 month consecutive period within the preceding 24 months.

Caltrans will need to increase efforts to help relevant control agencies and policymakers understand the intent and importance of this policy and how it supports near and long-term investment strategies.

4. Encourage Caltrans to Complete and Implement the Managed Lanes Business Plan

When multiple parties are jointly operating managed lanes, all partners need to have a clear understanding of roles and responsibilities. Regional agencies, FHWA, Caltrans, and CHP, may have differing expectations regarding design parameters such as lane-splitting, shoulder and lane widths and other issues associated with managed lanes. Regions generally place a priority on flexible design standards, while Caltrans and FHWA generally place priority on consistency, safety, and performance. CHP has concerns regarding safety and violation enforcement related to striping recommendations. Caltrans is working with stakeholders to address concerns with as much consistency as possible. Caltrans is also considering, among other things, performance measures, the use of automated data collection, updates to regulations governing statewide toll tag interoperability, and coordinated public education and messaging. These and related efforts will be important to achieve efficient planning and implementation of managed lanes projects in the emerging pipeline and others that may be considered.

5. Support Legislation to Empower the California Infrastructure and Economic Development Bank

Policy tools that draw upon a combination of credit and tax incentives can play an important role in advancing California projects. Many P3 arrangements result in a private sector entity borrowing funds to develop public infrastructure. As a result of the current credit crisis, private sector entities have approached the California Infrastructure and Economic Development Bank (I-Bank) for assistance in

accessing the bond market at favorable rates to finance P3 projects. The I-Bank's operating statutes¹ (the I-Bank Act) limit the I-Bank's ability to provide this type of assistance, which may be important to help finance current and future pipeline projects. Accordingly, the I-Bank has developed proposed legislation intended to facilitate further investment in public infrastructure by: (1) authorizing the I-Bank to loan the proceeds of conduit revenue bonds to private entities; (2) authorizing the issuance of conduit revenue bonds for the benefit of private entities or public entities able to repay the loan of bond funds; and (3) eliminating the current cap on the amount of bonds that can be issued to finance public infrastructure. (A draft legislative proposal is attached.)

6. Consider Legislation to Update Authority for Local Infrastructure Finance

One or more local transit agencies might be involved in the funding or financing of certain transit projects in the emerging pipeline. For these and other projects, local and regional agencies may need to consider the local infrastructure finance authority provided in Government Code 5956, sometimes referred to as the Infrastructure Finance Act. The legal structure contains a number of provisions that are believed by some to limit its utility. Issues include a 35-year limit on any project, limits on the use of tolls or fees, and the absence of an exemption from property taxes. Policymakers should consider amendments to achieve greater consistency with more recently enacted SBX2 4 in its treatment of these issues.

7. Explore Investment Strategies for California Pension Funds

The role of infrastructure investment within a pension fund portfolio is to provide reliable, long-term returns and cash yields through ownership or control of essential infrastructure assets or businesses that own them. Investments are typically in regulated and/or long-term contracted businesses. P3 investments, like infrastructure investments generally, can provide a suitable means for infrastructure investors to obtain targeted long-term returns and cash yields, and in some cases, inflation protection. Yet P3s are a distinctive class of infrastructure investments involving unique processes and considerations, including public-sector procurement processes, and a complex web of contracts and public-sector financing support.

California pension funds participating in California P3 projects, in addition to increasing the liquidity of the P3 capital market, would send a positive signal to the global investment community and increase public employees' engagement in the P3 process. From an institutional investor's perspective, however, public sector indifference or resistance to P3s, and fledgling P3 procurement models can result in long, expensive transaction lead times with highly uncertain outcomes. It seems likely, therefore, that the role of California pension funds will remain uncertain until the State's P3 programs become more stable and predictable. There should be further outreach and engagement with pension funds to better understand and overcome the barriers to their further investment in California's public infrastructure.

8. Initiate Early Collaboration on Environmental Matters

Various state, local and federal regulatory and permitting agencies have the authority and responsibility to administer environmental laws and statutes. Public agencies should work together in identifying process improvements to expedite specified projects while maintaining effective stewardship. Strategies might include:

- Where appropriate and feasible, establish priority project review teams to include federal, state and local authorities and encourage them to use innovative compliance strategies, e.g., concurrent review, EIR/EIS coordination, certified CEQA programs, tiered impact statements, mitigation banking and advance mitigation.
- To expedite individual project delivery, establish programmatic approval process by project type (environmental objective mitigation banking verses project-by-project mitigation or geographic-based coastal zone, goods movement or commute corridors).

¹ California Government Code Title 6.7, Division 1, beginning with Section 63000.

Often, however, those who approve environmental and permitting documents are different from those who approve engineering standards and specifications. Since the preparation of environmental documents often requires a certain amount of preliminary engineering, attempting to complete the environmental review process before inviting private sector input may unduly limit the sponsor's ability to achieve multiple benefits that might otherwise be achieved under a P3 approach. Project sponsors should, where possible, seek to address P3 delivery alternatives within the same timeframe as decisions on environmental and permitting issues.

9. Promote Best Practices for Securing Early Input from the Private Sector

Procurement processes can be lengthy and expensive for public agency sponsors and private bidders. Public agencies and private investors challenged to make efficient use of scarce time and resources may not give adequate consideration to public-private partnership opportunities unless the policies and processes are transparent, fair and efficient, the appropriate financial tools are available, and public benefits are clear. Public agencies should seek early opportunities to engage with the private sector on threshold issues like project risks, bid evaluation, and other terms in ways that increase confidence in the process and save time and expense. Yet, traditional procurement rules that are generally designed to prevent conflicts of interests and favoritism may also have the effect of constraining open discussions between public officials and potential private sector partners. In August 2010, BTH convened a roundtable discussion with attorneys active in the California State Bar Association. The roundtable participants agreed to help develop ways to increase cooperation between the public and private sectors, which includes State, regional, and local cooperation in the development of P3 projects. The State Bar could be asked to further assist in developing guidelines and best practices to be included in the Infrastructure Finance Academy curriculum and other training programs.

10. Consider Legislation to Clarify the Rules Governing Advisors and Conflicts of Interest

Different levels and agencies of government have differing approaches to rules governing advisors and potential conflicts of interest. For example, the *Federal Acquisition Regulation*, Subpart 3.6 ("*Contracts with Government Employees or Organizations Owned or Controlled by Them*"), provides that "special Government employees" retained for less than 130 days in a calendar year to provide "temporary duties" in the nature of expert advisors/consultants or as members of advisory committees are exempt from certain conflict of interest restrictions unless (1) the contract arises directly out of the special Government employee's activities, (2) the special Government employee is in a position to influence the award of the contract, or (3) "another other conflict of interest" exists. Under Subpart 3.6, the term "another conflict of interest" is not defined, is subject to case-by-case interpretations of the "Designated Agency Ethics Official" of the procuring federal agency. A different approach is found in the American Bar Association's *2007 Model Code for Public Infrastructure Procurement*, which provides that participation in a report or study that is subsequently used in the preparation of design requirements for a project shall not disqualify a firm from participating as a member of a proposing team in a design-build, design-build-operate-maintain, or design-build-finance-operate-maintain procurement unless such participation would provide the firm with a substantial competitive advantage.

In California, Government Code section 1090 prohibits *public officers* and *employees* from "being financially interested" in any contracts made in their official capacities. Both the California Attorney General and the California Court of Appeal have interpreted section 1090 to include professional consultants hired on a temporary basis to provide advice in connection with contracting decisions, even if the professional consultant would be considered an "independent contractor" under common law principles. Thus, a financial consultant hired early in the procurement process to advise a public agency on the suitability of a particular P3 could be liable for a section 1090 violation if, based on the consultant's advice, the public agency executes a P3 agreement with a party in which the financial consultant is deemed to have a financial interest. The resulting P3 contract may be voided in an action brought by "any party," and if so, any compensation paid to a private entity under the void contract would have to be repaid to the public entity. One possible approach to mitigating these risks would be to expand the "remote interest" exception to the section 1090 prohibition by amending section 1091 to include, for example, that of a professional consultant retained temporarily by a public agency to advise on contracting decisions where the professional consultant is not an employee, officer, owner, partner, or agent of the ultimate contracting party. (A draft proposal for discussion purposes only is attached.)